



# Regulated Financial Institutions Alert

Developments in financial institutions law

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## Lenders face tougher standards under new mortgage bill

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On March 26, 2009, Rep. Brad Miller (D-NC), Rep. Mel Watt (D-NC), and House Financial Services Chairman Barney Frank (D-MA) introduced the Mortgage Reform and Anti-Predatory Lending Act of 2009 (H.R. 1728). The bill is considered a more stringent version of the Mortgage Reform and Anti-Predatory Lending Act of 2007 (a bill introduced by Rep. Miller that was passed by the House, but never considered by the Senate). If the bill becomes law, the business of mortgage lending may change dramatically, which could result in certain non-depository mortgage lenders going out of business.

The purpose of the bill is to curb risky mortgage lending by establishing underwriting standards that ensure borrowers qualify only for those loans that they can repay. Every residential mortgage loan would be subject to two standards: (1) that the borrower has a “reasonable ability to repay” the loan (at the fully indexed, fully amortizing rate), and (2) for a refinancing, the loan will provide a “net tangible benefit” to the borrower (the bill directs the federal banking agencies to jointly define “net tangible benefit” but provides, as a guiding example, loans for which the cost of refinancing exceeds the newly advanced principal do not provide a net tangible benefit).

Here are some important features of the bill.

- 1) *Qualified mortgage safe harbor*: The bill includes a safe harbor for prime, fully documented, 30-year fixed-rate mortgages that do not have negative amortization or interest-only features. These loans are presumed to satisfy the ability-to-repay and net-tangible-benefits standards (a presumption that is rebuttable). Qualified mortgages include the following characteristics:
  - (a) The APR does not exceed the average prime offer rate, published by the Federal Reserve, by more than 1.5 percent for a first mortgage and 3.5 percent for a second mortgage.
  - (b) The income and financial resources of the borrower are verified.
  - (c) The underwriting process is based on a fully indexed rate.
  - (d) The loan meets a combined debt-to-income (DTI) test prescribed by the federal banking agencies.
  - (e) The loan has a fixed rate and term of 30 years.

A press release issued by the House Financial Services Committee states that the bill encourages movement toward 30-year fixed-rate, fully documented loans because the growth of exotic mortgages was a major factor in the housing and foreclosure crisis.

2) *Credit risk retention*: Federal banking agencies would be directed to issue joint regulations that require lenders to retain at least 5 percent of the credit risk of each loan that they originate and later sell or transfer to a third party. However, the credit risk retention requirements would not apply to qualified mortgages.

This requirement is a significant concern for the mortgage bankers because they are lenders who do not have a capital base that can be tapped into to provide the necessary 5 percent credit risk retention. They may be forced to originate only qualified mortgages or exit the mortgage lending business.

3) *Federal duty of care*: A federal duty of care will be established, which will require all mortgage originators (including banks and non-bank institutions) to:

- (a) be properly licensed and registered under state and federal law (including under the Secure and Fair Enforcement for Mortgage Licensing Act of 2008);
- (b) present borrowers with appropriate mortgage loans (loans that do not have predatory characteristics and that borrowers have a reasonable ability to repay, and for which the borrower receives a net tangible benefit);
- (c) make full disclosures to borrowers;
- (d) certify to creditors compliance with mortgage origination requirements; and
- (e) include a unique identifier of the mortgage originator on loan documents.

4) *Liability*: A mortgage originator who violates the duty of care will be liable to the borrower for the greater of actual damages or an amount equal to three times the broker fees plus costs (including attorneys' fees).

5) *Steering incentives*: Yield spread premiums and other forms of compensation used to encourage mortgage originators to "steer" borrowers toward more costly mortgages would be banned on all mortgage loans. The total direct and indirect compensation received for a mortgage loan shall not vary based upon the terms of the loan (except for the size of the loan and the number of loans).

6) *Lender liability*: In addition to remedies under the Truth in Lending Act, a lender that violates the ability-to-repay or net-tangible-benefit standards is liable to the borrower for rescission plus the borrower's cost for the rescission (including attorneys' fees), unless the lender can provide a cure within 90 days of receiving notice from the borrower. The cure is to provide a no-cost modification or refinancing that conforms the loan with the minimum standards existing on the day the loan was made.

7) *Assignee/securitizer liability*: The lender liability (set forth above) extends to assignees and securitizers of the original mortgage loans, unless the assignee or securitizer can provide a cure as set forth above.

8) *No investor liability*: “Assignee” and “securitizer” do not include the investors who purchase securitized loans or loan pools, or investors in instruments that represent interests in loan pools.

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